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March 1, 2000 **LETTER 1297**

Feb. 11 DJIA 10425.21; PTI 5167; A-D Ratio -6.14
Feb. 18 DJIA 10219.52; PTI 5155; A-D Ratio -6.75
Feb. 25 DJIA 9862.12; PTI 5137; A-D Ratio -7.44
Dow Yield: 1.57%; Dow Price/Earnings: 21.2%
Dow Times Book Value: 5.83 ; PTI 89-day exp. MA: 5205
Percentage of Undervalued Blue-chips: 14%
Gold 34-day MA: 296

Russell's Bear Market Rule: "In a bear market everyone loses, but the person who loses the least is the winner."

THE PICTURE: What has made this stock market so difficult? Why has this stock market defied classic analysis for so long? And why has this stock market been one of the most volatile in Wall Street history?

I don't think there's any one single answer to the above questions, but I do think it's the result of a number of phenomena that have all come together. Let's examine them.

The first is **massive liquidity.** In an effort to ward off a potential disaster brought on by Y2K, Greenspan pumped reserves up, up and off the charts. When Y2K proved to be a non-event, Greenspan was very reluctant to reduce reserves. Or as Jim Grant (*Grant's Interest Rate Observer*) puts it, "The Federal Reserve continues to expand its balance sheet at double-digit rates. . . Commercial bank credit continues to boom, and growth in the money supply available for immediate spending – 'money of immediate maturity,' or MZM – registered 6% in January."

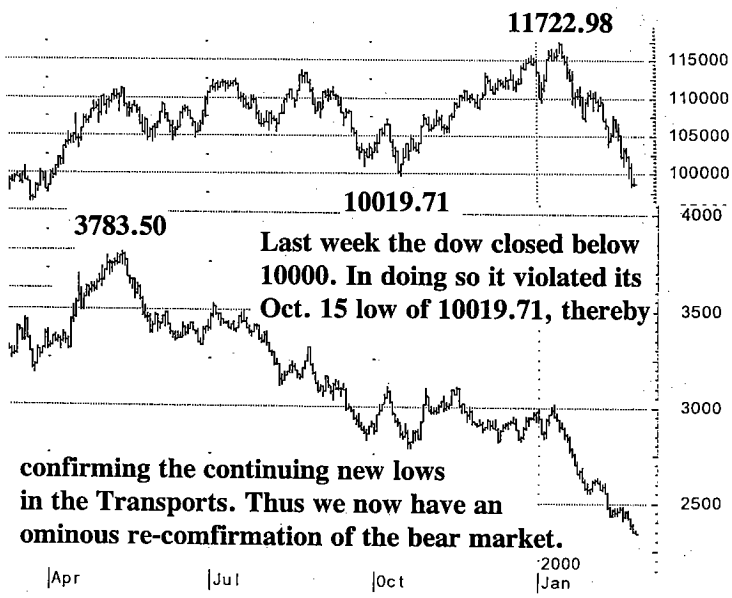
On top of that, as *Reuters* (Feb. 18) put it, *"Wall Street on Drunken Binge. There's a lot of craziness on Wall Street. A Clue? Investors are borrowing money like a bunch of drunken sailors so they can buy already overpriced stocks. Buying on margin, the Street's version of charging stock purchases on a credit card, went up a heart-pounding pace in January, climbing to a record $243.5 billion from $228.5 billion in December. A decade ago the debt load amounted to just $35 billion."*

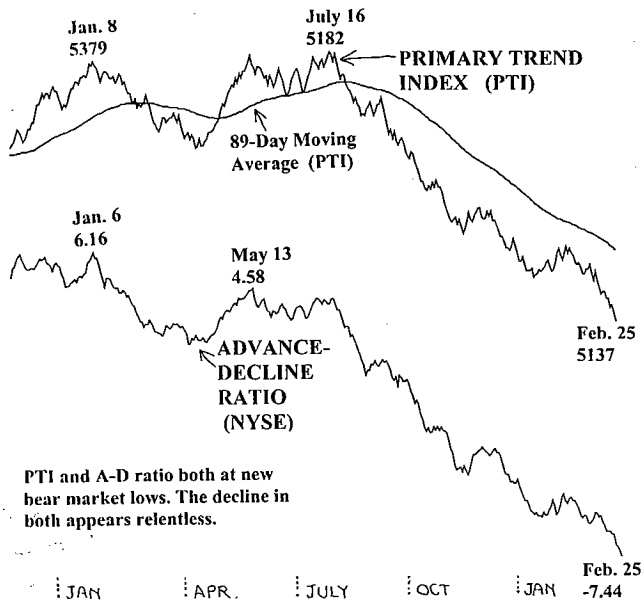
So it's obvious that Fed-head Greenspan has painted himself into a corner. By allowing reserves to rocket up to undreamed of levels, by failing to raise margin rates, the Green man has allowed Wall Street to build a market bubble of incredible proportions. Greenspan's problem: How to deflate the bubble without sending the stock market and the economy into a tailspin? It's a problem that is probably keeping Greenspan awake and walking the floors at night.

Of course, a second '90s phenomenon is the entrance of the public to an extent never seen before. At present, half of all the families in the US own common stocks or funds or both. More ominous, the public now considers stocks and funds as "savings." Much of the public's money is handled by fund managers who are under tremendous pressure to "out-perform the S&P." Under pressure to out-do the S&P, these managers (plus, of course, day-traders) rush into "where the action is," thus exaggerating any trend. Obviously, the trend today is to be well-represented in tech, net and more recently biotech stocks.

A third and very important phenomenon is that the big stock averages such as the S&P and the Nasdaq, and to a lesser extent the Dow, are no longer a measure of the broad market. **Rather they are a measure of the much narrower high-growth sector of the market.** You can see how the people at Dow Jones have struggled to make the Dow more "growth-oriented" by inserting Microsoft, Intel, Home Depot and SBC in the Dow while removing four stocks which are all "mired" in the "old economy."

Thus we have the spectacle of the big averages still not too far from their highs while 78% (this is the latest figure) of the stocks on the NYSE are BELOW their 200-day moving averages and are thus in established bear trends.





A fourth phenomenon (and this is the least understood) is that increasingly analysts are looking at stocks **as derivatives, specifically as options on growth.** This is the reason why tech and growth stocks have been selling at such extreme price/earnings ratios -- and even why so many tech and net stocks with no earnings at all are selling at multiples of "what earnings might be somewhere ahead if or when the stock is finally expected to generate earnings."

So the old value system has pretty much been jettisoned in favor of what I call the "option method" of pricing stocks. All tech and net stocks are now simply "options on earnings." This is the real reason why there is such an obsession on quarterly estimates vs. actual earnings. The leverage (both up and down) on options is huge, and thus stocks careen up and down (maybe up or down 30%) based on bettering or not bettering "expectations" or First Call or even the "whisper numbers."

Fifth, we have the wide influence of the media, and particularly TV and even more specifically CNBC, which, it seems, "everybody" watches. CNBC provides a steady diet of serious discussion, hype, bullish predictions and most of all -- a continuous parade of "expectations" of quarterly earnings. This is the home of the "one penny better than analysts' expectations." Why, you ask, are so many quarterly earnings coming out just "one penny better than expectations." The answer is because this "one penny better" keeps the given stock in the growth groove. And growth is where it's at, steady growth is what allows analysts to put such outrageous valuations on stocks that are selling at mind-blowing P/Es of 75, 100, 150 or even outrageous multiples of sales in the many cases where there are no earnings.

Conclusion: The old standard of buying an "attractively valued" stock that sells at 10 to 12 times earnings, a stock that provides a dividend yield of say 5.5%, a stock that may be growing at say 3% a year, that kind of stock and that kind of analysis is out the window. Today analysts (who are essentially herd-animals) would rather buy a stock that earns 45 cents this year and hopefully 85 cents in 2001 and $1.70 in 2002. This stock may sell for 100 times current earnings and 150 times next year's expected earnings. In other words, you're not buying a value, you're buying a "call on projected earnings." Of course, if the stock comes up with a "bad quarter" it can drop 30% overnight.

This is the market we have today. To the fresh young operators of the '90s, it's an exciting gamblers' market where the key words are "action," "profits by the hour" -- and long-term is maybe from now to the close. To old-timers it's a freaky, fantasy market run by "kids" who have never seen a bear market, never lived through hard times and whose motto is "in Greenspan we trust."

Confession: When I write about the stock market (and I do this almost every day) I try to write about the market without any personal hopes, wishes, or pre-conceived notions. I try to write as a person who doesn't give a damn whether the Dow goes up or down or whether the Dow is in a bull or bear market. What I try to do is analyze the stock action ex-emotions. If the Dow wants to go to 15000, that's fine with me. If the Dow wants to smash below 10000, that's OK with me, although for the sake of my subscribers I would like to be the guy who issues the warning.

According to my studies, this market is now living on borrowed time. I believe we're in a bear market, and I seem to be one of the few who hold this belief. I have directed my subscribers' attention to the technical troubles ever since the advance-decline ratio topped out on April 3, 1998. Since then, I've documented the steady deterioration via my "top-out parade" plus daily (Internet) discussions of the various sagging or sinking averages and indicators plus the flagrant divergences on the part of the advance-decline ratio and the Transportation Average.

I don't happen to like a diverging market or a deceptive market. But in the end we take what the market gives us. In due time what's happening will become clear. Over any extended period of time, the market will tend to trade as a "unit" with roughly **85% of all stocks either rising together or falling together.**

I've said all along that this bear market is going to start with **attrition,** a slow but steady erosion in the majority of stocks. Of course, the nasty thing about attrition is that it tends to keep stockholders holding their stocks. Attrition tends to keep stockholders holding, hoping, waiting for the rally that will turn their losses into profits or (later on) bring their stocks back to the point where they can at least break even.

But the bear doesn't want that to happen. The bear wants to encourage stockholders to hold onto their stocks. The bear has no mercy and no conscience. The bear's business is that of producing losses. Or, as the patient investor on the sidelines might put it, the bear's business is to generate great values -- the hard way, over time - with the stock market heading down.

CURRENT: In his Humprey-Hawkins speech a few weeks ago Greenspan made it clear that interest rates will continue to rise until either the stock market or the economy or both cry "uncle." At the same time the advance-decline ratio and my PTI continue to sink to new bear market lows.

Thus it is clear that (1) the stock market is now fighting the Fed. and (2) the stock market is now fighting the tape.

There remains only one question, and it is -- "Can the tech stocks and the Internet stocks and the biotech stocks continue to advance or even hold up in the face of the above?"

In my opinion, there is no way the nets/techs/biotechs are going to hold out against a broad decline in both the "backbone of the economy" type stocks and a rising trend in interest rates.

Irony: In November of last year Dow Jones took out four "old economy" stocks and replaced them with four "new economy stocks," namely Intel, Microsoft, SBC Communications and Home Depot. Great move? Hardly. Since then, Microsoft is slightly higher, SBC and Home Depot have been heading south and only Intel has been a good performer.

Breadth: I think the KEY to this market is the relentless deterioration in the advance-decline ratio. Day after day, week after week, month after month, we see more issues declining than advancing. At this point the sinking breadth has resulted in 75% of the stocks on the NYSE breaking below their 200-day moving averages.

If breadth continues to sink, it will be only a matter of time before ALL stocks head down, and I'm referring specifically to the techs, the nets and the biotechs.

Here's a lesson I learned back in 1957. In July of that year the market turned down, and the Dow in the 520 area headed down towards a late-'57 low of 419. The hot stocks at the time were the international oils. I had wanted to buy Texaco, which during the decline had held up remarkably well. The market continued to decline, but Texaco just would not give up any points, and I became increasingly frustrated. Finally, towards the end of that vicious market correction Texaco just "gave it up." Texaco along with the rest of the international oils dropped drastically, and I ended up buying TX at an even lower price than I had envisioned.

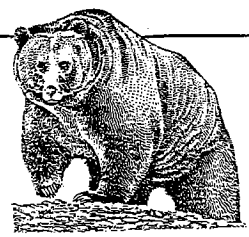
But I never forgot that lesson. If the broad market continues relentlessly down, before the decline is over, even the strongest hold-outs will head south, often rapidly as if to make up for lost time (tech, net, biotech stocks take notice).

As this is written, 78% of all the stocks on the NYSE are below their 200-day moving averages. The Dow and the S&P are both below their 200-day moving averages. This is a bearish picture.

My own belief is that the stock market is telling us that despite the currently "bright" picture for the economy, trouble lies ahead. What kind of trouble? Again, if I had to guess, I'd guess that it's going to be trouble from the US consumer. I think the consumer, now loaded with debt, is going to pull in his buying during late spring and summer. Since two-thirds of the US GDP is based on consumer buying, a contraction of buying by consumers could easily throw the nation into a surprising recession.

Backing up this thesis is the broad collapse in most of the retail stocks from the Gap to May Company to Abercrombie to K-mart. The collapse has been dramatic and vicious. It's hard for me to believe that what's happened to the retail stocks is meaningless.

INVESTMENT POSITION: That the bear is in the box should come as no surprise to my subscribers. I've been talking about this bear market for months.



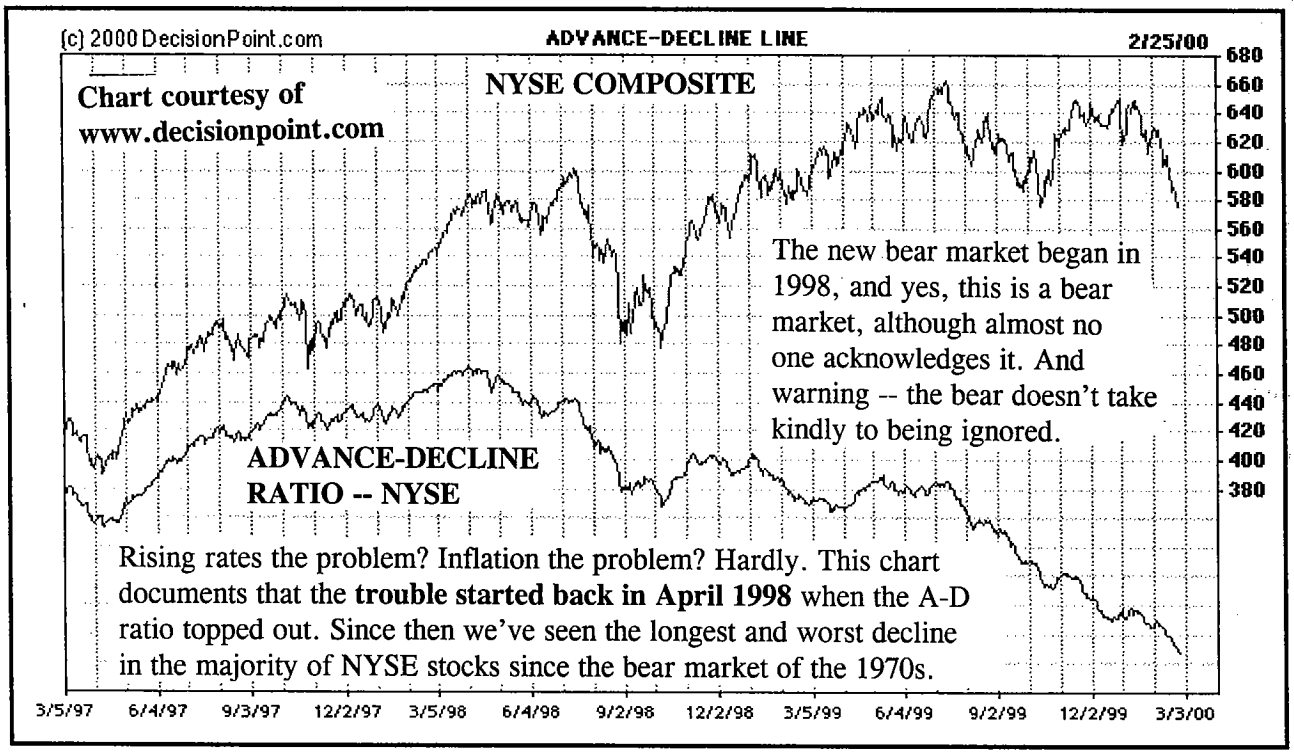
The idea now is to avoid losing money, or at least to lose as little money as possible. I want to keep it simple, so I'll say that the best position is to be in various lengths of US Treasury debt.

What are the ideal lengths. Off hand, I'd say that 50% of your money should be in T-notes of three-years or less. The rest might be placed in T-notes that are out five and ten years.

In a bear market TIME tends to work against the holder of assets -- regardless of whether those assets are in real estate, stocks, art, land, you name it. This is particularly true, of course, in cases where the bear market starts from a high or overvalued level in the stock market and again where the bear market tends to be severe in both duration and extent.

Will this be an extended and deep bear market? Honestly, there's no definitive way of knowing. However, as a rule, the greater the bull market the greater the ensuing bear

market. On that basis, I would think that we're in for a devil of a bear market.



NOTES & QUOTES: Penny: Every year or so the powers in Washington talk about eliminating the penny. Forget it, it's not going to happen. Why? Because the penny is needed to describe a lot of the quarterly earnings now being announced by Internet and tech firms. It seems that every other report talks about some company "beating analysts' expectations by one penny." Hey, eliminate the penny and how would these guys describe their fabulous earnings "growth"?

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Cisco Systems a few weeks ago reported earnings up nearly 50% and its shares rose to 136. This put its market cap at $465 billion. That surpassed GE's cap and places Cisco within shooting distance of MSFT's cap of over $500 billion. One analyst stated that Cisco was on the road to becoming the first trillion dollar company. But at twice today's price Cisco would trade at about 260 times estimated fiscal year 2000 earnings. By any reckoning, that's a super-expensive stock.

* *

Marketing News of two weeks ago predicted a coming crash of the dot-coms by the end of the year. They believe that "90 percent of existing dot-coms will be gone, or on their way out, by the end of 2000," and e-marketers will be jumping ship. "Most of the dot-com companies may not suffer from lack of development funding, but many have failed the test of efficient branding. Time has become a lot shorter to keep up with the pace of business, especially the pace of e-business. In general, dot-coms have not spent enough time on building relationships with their consumers."

The Russell take is that there are just far too many dot-coms. As I read the many full-page dot-com ads that appear daily in the newspapers, I just can't keep up with who they are and what in the devil they are saying or doing or selling.

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It's just incredible, the sheer amount of money that venture capitalists are throwing at the new Internet companies. The following is a quote *(NY Times*, Feb. 7) from Fred Wilson of Flatiron Partners (they were early players in New York's Silicon Alley). *"The rate of company creation going on is unsustainable. I would not be surprised if there were 20 or 30 new Internet companies a day being formed in New York. That's scary. People are forming companies for the wrong reason. They aren't passionate about their ideas. They just want to be millionaires like all their friends, and there is so much capital in New York that anybody can start a company today."*

An article in the Feb. 20 **WSJ** notes that everyone wants to be a venture capitalist or at least have money in a venture capitalist fund. When new venture funds are established, the rush to put money with these funds is so intense that much of the new money must be rejected. One $700 million fund received bids almost overnight for $2 billion in new money, must of which had to be turned down.

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Say It Isn't So Dept: Bill Gate's position as the world's richest man may soon be challenged. The challenger is Masayoshi Son, founder of Softbank, the Japanese internet investment group. At last week's closing share price, Son's 38.2% stake in Softbank was worth almost $70 billion, meaning that Son is closing in rapidly on Gate's net worth.

* *

Prices of homes in California's Silicon Valley are reaching the fantastic. Two weeks ago a tiny one-bedroom house in Palo Alto went on the market. Seven offers were made for the 792 square foot home, all above the asking price which was $409 thousand. The house was sold for $550 thousand. The house had attracted hundreds of buyers on two open-house days in January. The market for houses is so hot that almost all sales are above the asking price. Alan Dunkel, a real estate agent, told the *Mercury News,* "This is what's happening out there, and it's scary."

The same thing, it seems, is happening in London. An article in the Feb. 20 *Financial Times* tells the story. When a US real

estate outfit merged with a British firm, its CEO, Stuart Scott stated, "The first thing which hits you when you come over here is sticker shock. You cannot believe what people are asking you to pay. Everyone is told things cost 20% more in London. In fact, you pay in pounds what we pay in dollars (the pound is now worth $1.61). **Russell Comment:** Why in the devil prices in Britain should be 25 to 50% above prices here I never could figure out. Remind me to stay in La Jolla, where the weather is great and I can still get an excellent meal (grilled salmon, potato, salad, bread) at Bully's (this is the "early bird special") for $8.95. And I like to eat early.

* *

It looks like everyone is running against Clinton (in a C-Span poll of 58 historians, Clinton finished number 21 for performance in office and 41 or last of all US Presidents for morality.) The White House angrily denounced the survey....Hillary has literally dropped the Clinton from her name. Now let it be known, she is just HILLARY..Almost all the Presidential candidates are emphasizing they are honest and outspoken, the very essence of a non-Clinton. Writes *The Christian Science Monitor*, "the name 'Clinton' has been something like a hand grenade, to be tossed back and forth from one candidate to the other. So when Mr. McCain states that Bush 'twists the truth like Clinton,' an outraged Bush comes back charging defamation."

In the meantime, the Republican party is scared to death of "loose cannon" McCain. Writes the latest *Economist,* "The explanation of all this hostility is simple: Mr. McCain represents a gigantic threat to the way the establishment does business. At the very least, his campaign against the 'iron triangle' of 'lobbyists, big money and legislation' is going to change the way Washington works. It could well end up altering the balance of power in all sorts of unforeseen ways, perhaps even playing into the hands of the Democrats, with their lock on union dues and their automatic support from feminists and teachers. 'He's my best friend,' say Phil Gramm, who enlisted McCain to run his campaign for the presidency in 1996. 'But his views on campaign finance would make us a minority party for 25 years.'"

* *

Japan would seem to be sinking back into technical recession based on figures released two weeks ago which show that Japanese households have cut back on their spending for an unprecedented seven consecutive years. This trend has been largely responsible for the collapse of the yen vs. the dollar. Remember, strong economies tend to generate strong currencies.

Speaking of Japan, wife Faye was in Paris about seven years ago, and she told me that at the Chanel store young Japanese girls were lined up and buying every expensive item in sight (of course, all Chanel items are expensive). A few years ago you could walk down Girard Street here in La Jolla and bump into Japanese tourists everywhere. No longer. Times have changed in Japan, and Japanese consumers have been cutting back for seven consecutive years. Could cut-backs ever happen here? Nah, not a chance. Get real.

* *

One of the milestones of this "stealth bear market" has been the collapse of one of the great wonder-stocks of the '80s and '90s, Warren Buffett's Berkshire Hathaway. Revered as an investor demi-god only 18 months ago, suddenly Buffett's fans are silent. The reason -- Berkshire's decline from a 1999 high of over 81,000 to 42,100 two weeks ago, a shocking loss of over 43%. Buffett has stated that he has never understood technology stocks and that he has never bought any (although he recently bought a bit of MSFT). Instead Buffett stayed with Geico and Coke and Gillette. Great consistency, but big mistake. Buffett is a value investor but the market didn't want values, it wanted tech/nets instead. With Berkshire now below 45,000, however, I have to wonder what will happen to this stock when the bear market gathers steam and consumer start cutting back on the purchases

* *

I continue to believe that the Internet will prove to be a major force for DEflation. The Internet renders the world completely global. That means that production will increasingly be moved from high-cost locations to low-cost locations. Furthermore, the net puts pricing increasingly in the hand of the consumer rather than the manufacturer. As consumers become more sophisticated, every purchase will be subject to price-comparisons. And there will always be someone who is willing to sell a given product at a lower price. The level of consumer sophistication is still very low. A third of my subscribers, for instance, are not even on the net, and my subscribers are far more sophisticated and intelligent than the general population. But as access to the net increases, the pressure is going to be on prices and competition is going to be vicious (it already is). Deflation, it's the hand-maiden of the Internet.

I keep up with most of the sports, but as an old track man (100 yd. dash, broad jump) I've always been particularly interested in track. There are many remarkable athletes competing today, but one of the most incredible is Johnny Gray, who won the Milrose 500 three weeks ago at Madison Square Garden (Gray has made FOUR Olympic teams). What's so remarkable about Gray winning the Milrose 500? Just that Johnny Gray will be 40 years old in June. He set the Milrose record 14 years ago, and he's still the man to beat. I don't know if you've ever run the difficult middle distances, but they are tough; they entail endurance, speed and strategy. Johnny Gray must be a freak of nature. I've never seen anyone like him. Winning the 500 at age 40. Unbelievable.

* *

I had my second epidural steroid shot in my back. I feel a lot better. The big question in my mind is how long the good effects of these shots will last. I've heard not too long. I'll keep you posted. So far, they're a definite plus.

* *

As for you heart patients, let it be known that the authorities are still trying to kill chelation. I talked to my new cardiologist a few weeks ago. Me: "I don't know if I should admit this, doc, but I've had over 100 chelation treatments. And so far, since I started chelation in 1995, I've had no more heart trouble and I now very seldom get angina." He: "You know that chelation is essentially worthless. It certainly hasn't been proved." Me: "Gee, doc, but neither has surgery been 'proved'." At which point the good doctor laughed and said, "Well, you've got a point there." The clip below was sent to me by a Florida subscriber. The Florida guys are trying to downgrade chelation. Russell advice: "Give it up, guys, chelation works and like a great idea whose time has come, you can't kill it."

ASSOCIATED PRESS

JACKSONVILLE — Florida's Board of Medicine is asking for public hearings on chelation therapy, a fast-growing alternative medicine for heart disease and life extension.

Board members said they were reacting to a newspaper series that found chelation therapy is attracting dozens of Florida doctors with troubled pasts.

The *Sun-Sentinel*, South Florida, documented that 29 percent of 146 doctors who offer chelation therapy have been sanctioned by the state's medical or osteopathic licensing boards.

The hearings by the board's alternative-medicine committee could result in tighter controls over the therapy.

Advocates of the practice say chelation treatments can cure coronary artery disease and other ailments, and even retard aging, but most conventional doctors think it is of little value.

* *

Prices: I'll admit it, the full page Armani ad in the Feb. 11 *NY Times* had me doing a double take. The ad showed a man in an Armani suit, shirt and tie. The suit was priced at $1,895. Hasn't an ounce of gold been able to buy a "good" man's suit over the years? Today, it will take almost six one-ounce gold coin to buy this suit (is the suit too expensive or is gold too cheap?). Then a "blue striped dress shirt", cotton, shown at $115. What? A cotton shirt at $100? And finally, a "sage green silk tie" at $96. Back in the '50s my father used to buy the finest silk tie on the

market at Sulka's for $5. Armani's price is 19 times that. What's happening? I don't know--blame it on the Fed and the collapse of the dollar's purchasing power.

* *

I guess I'm a PAC 10 guy. Wife Faye went to Stanford, son Ryan at Cal, daughter Lauren at Arizona, all PAC 10 schools. When they play, I never know who to root for. Stanford just announced a 6% boost in tuition, which will be $32,471 for 2000-2001. Whew. Can't believe how my old alma mater, NYU, has grown and changed. When I attended NYU back in the '40s, almost all the students were from NYC. Now 80% come from outside the City. SATs for new students are the highest ever. And NYU has become a major force in NYC and one of the great universities in the nation. Its campus? The City of New York, although NYU has practically taken over Greenwich Village.

* *

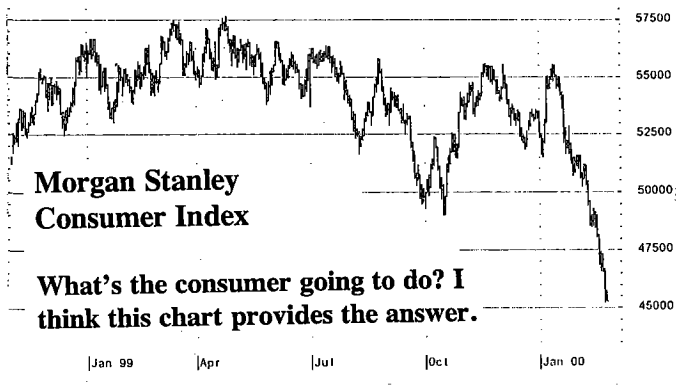
March 7: Californians vote on Prop. 1A. If it passes (and it will) the states' Indians will be allowed to provide Vegas- type gambling with slot machines and all. Thus California will finally compete with Las Vegas, but more importantly, much of the taxes which Vegas has collected from Californians will go to California. If the bill goes through Las Vegas can expect a 6.9% drop in revenue, Reno casinos can expect a 21% revenue drop and Laughlin should brace for a 15% drop. Nevada casinos currently take in 35% of their $7.7 billion in annual revenues from California. Those days are just about over.

* *

On my Internet site, just the night before Kirk Kerkorian made his bid for Mirage, I said that Mirage's stock (MIR) was so low (it was 10 7/8, down from 30) that it was perfect bait for a takeover. Sure enough, Kerkorian made his bid of 17 for Mirage next day. Shrewd move by Kerkorian -- if he gets MIR he'll practically control the Vegas strip since he'll own the Mirage, MGM Grand, New York, New York, Bellagio, Treasure Island and half of Monte Carlo. Kirk also controls Hollywood's Metro-Goldwyn-Meyer -- and all this at the tender age of 82.

PRECIOUS METALS: How about the metals? Don't ask. There really isn't much I can say here about gold, or I should say there isn't much encouraging to say. When platinum and palladium surged, palladium to new record highs, gold and silver hardly budged. Feb. gold futures hit a recent high of 323 on February 7. Since then gold has declined and three times tested the 300 level. But on February 25 the Feb. gold futures broke sharply below 300, and that was a decided negative.

Why? What's wrong. Does it really matter? Well, yeah, I guess it does. My humble guess -- gold sees something ahead that it doesn't like -- maybe an economic recession starting in late spring or summer -- which I think would be deflationary. Or maybe accelerating world competition via the Internet -- which I think will be deflationary. The crux of it is this -- gold is now lower than it was four months ago. And that's discouraging.



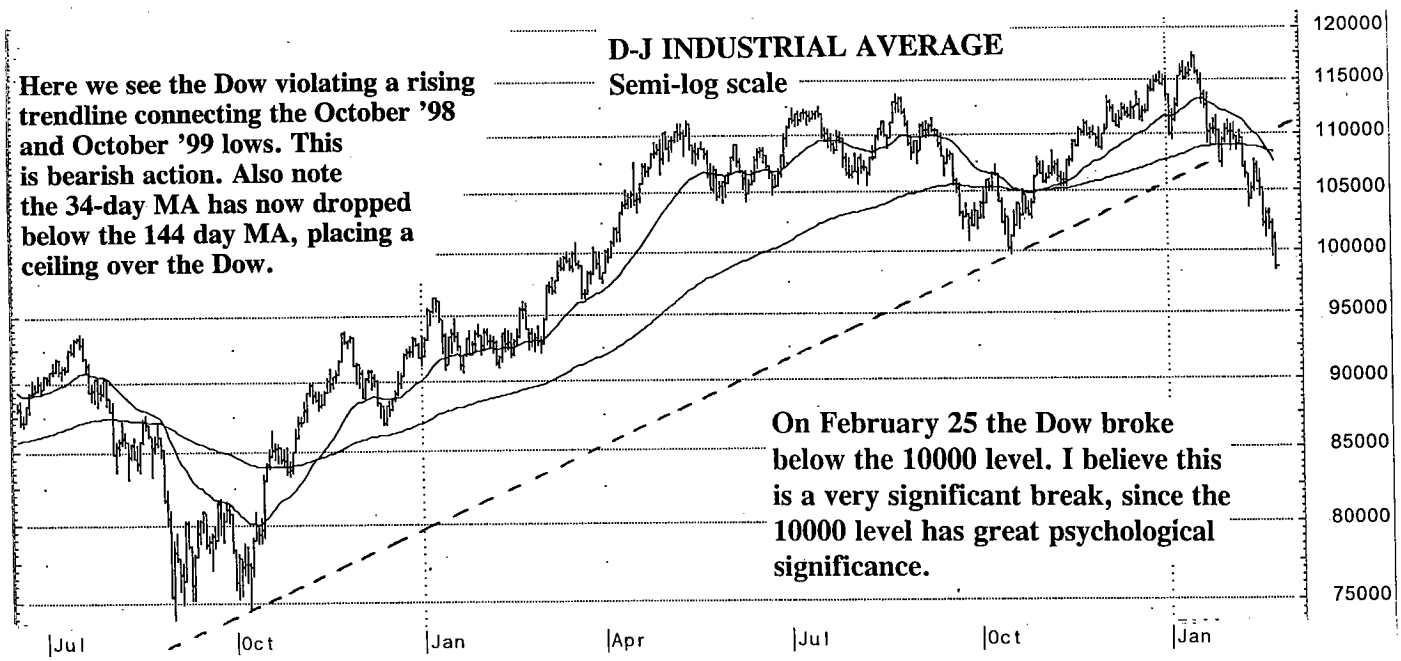
Morgan Stanley Consumer Index

What's the consumer going to do? I think this chart provides the answer.

LATE NOTES: Incredibly, option buyers are buying twice as many call as puts, meaning that they are definitely playing for the upside. Note also that the S&P futures are consistently higher each morning at the market opening, indicating that traders are convinced that "today the market will be higher." Finally, almost no one recognizes that a bear market is in progress -- this bear market is getting no recognition. And that makes bruin very, very angry.

In *Barron's* and elsewhere, not a word about a major bear market. Simply incredible, unbelievable arrogance, and a fantastic display of ignorance.

NEXT MAILING: March 22


D-J INDUSTRIAL AVERAGE
Semi-log scale
Here we see the Dow violating a rising trendline connecting the October '98 and October '99 lows. This is bearish action. Also note the 34-day MA has now dropped below the 144 day MA, placing a ceiling over the Dow.
On February 25 the Dow broke below the 10000 level. I believe this is a very significant break, since the 10000 level has great psychological significance.
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